

## US Elections 2024

Image source: iStock/MicroStockHub

As we approach the US Presidential election, the race remains highly uncertain, with both candidates neck and neck in the polls. The upcoming debates, along with recent events like Joe Biden's health issues and an assassination attempt on Donald Trump, have added to the unpredictability of this election, which could significantly impact the US economy and financial markets. Let's explore the key issues at stake and how the election outcome may affect equity and bond investments.

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We are now less than two months away from the US Presidential election. The first debate between Kamala Harris and Donald Trump will take place tomorrow, September 10th. A second debate will be organised in October, after the Vice-Presidential candidates have a dedicated debate on October 1st. The outcome of this election is highly uncertain, as the two candidates are currently neck and neck in the polls.

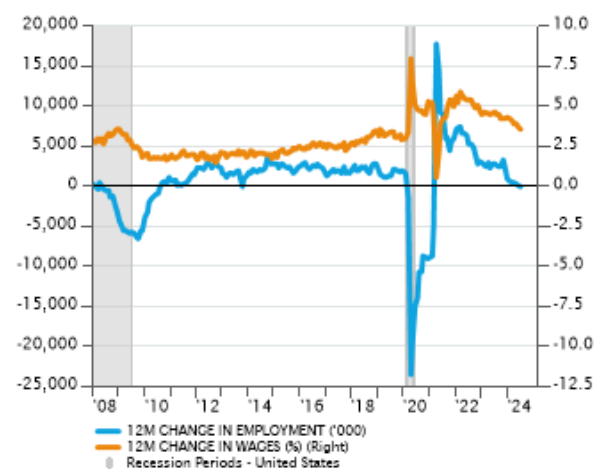
The summer's events, including Joe Biden's health issues, a poor debate by the incumbent president, an assassination attempt on Donald Trump, and Kamala Harris's nomination, have created uncertainty in what was expected to be a 2020 election remake.

Yet, the agenda of the two candidates is radically different, and the upcoming election could alter the course of the US economy for the years to come. Uncertainty will likely fuel volatility on financial markets in the weeks ahead of November 5<sup>th</sup>. Depending on the outcome and the composition of the Congress, sectorial divergences in performance are to be expected in equity markets. Bonds markets will need to adjust to the impact of new policies amid slowing economic growth, rising public deficits, and the Federal Reserve's rate cuts. Let's look at the main issues at stake in this campaign and the potential impact of the election on equity and bond investments.

### An election with slowing economic growth in the background

The US economy has shown surprising resilience over the past two years, enduring the worst inflation in decades and a brutal cycle of interest rate hikes, despite sluggish global economic growth. A very strong labor market associated with savings accumulated during the Covid pandemic have long fueled consumption spendings in the service sector. Those two drivers have sustained solid GDP growth, despite the weakness of some cyclical and interest rate sensitive sectors such as manufacturing and real estate. However, the impact of a very tight monetary policy by the Fed is being felt in 2024, as the employment market gradually cools off and allows for a slowdown in wage growth. The Fed had been waiting to be confident that the inflation was finally contained, which Jerome Powell has signaled by announcing that a rate cut cycle is set to begin.

#### **Employment growth stalls, easing pressures on wages but rising fears of a recession**



Recent economic data has raised fears that this growth slowdown could eventually turn into a recession at the crossroads of 2024 and 2025. As always, the economic situation will be crucial in the election, as any downturn could be blamed on Kamala Harris due to her key role in the current administration. In that respect, the evolution of US economic data in the weeks to come will be crucial not only for company earnings and interest rates but also for the election outcome, as the saying goes, "it's the economy, stupid."

### Two fundamentally different economic agendas

There's still time before the election, and both candidates are likely to flesh out their programs in the coming weeks to try to tip the balance in their favour. Still, Kamala Harris and Donald Trump have already outlined several economic measures that they will push forward if they reach the White House. Unsurprisingly, the philosophy of their agenda differs fundamentally and could set the US economy on different trajectories depending on the outcome of the Presidential and Congressional elections. Beyond a bipartisan agreement to protect the US industry from Chinese exporters, the anecdotal shared proposal of removing taxes on tips, and a common intention to boost the housing market, the Republicans' and Democrats' economic programs are almost diametrically opposed.



Kamala Harris' economic program is logically in continuity with the policies implemented under Joe Biden's presidency. The Democrats' platform is a set of redistributive policies where fiscal support to families and low-to-middle income households would be financed by higher taxes on corporates and wealthy households. The emblematic economic measures championed by the current Vice-President are tax breaks for households with children, fiscal support to first-time homebuyers, a higher federal minimum wage, various forms of price control in several sectors (i.e. food, rents, prescriptions, bank fees), and an increase in the corporate tax rate from 21% to 28%.

In contrast, Donald Trump is campaigning on a program of reduced federal intervention in the economy, with lower regulation in several areas (energy, banks, utilities, healthcare, housing market), an extension of individual income tax cuts introduced during his first presidency, lower taxes on social security benefits, the reversal of subsidies for green energies introduced under Joe Biden, and a cut in the corporate tax rate to 15%.

The necessity to push back on China's aggressive mercantilism is one of the few bipartisan issues agreed on by Democrats and Republicans. The outgoing Biden's administration, of which Kamala Harris belongs to, has taken significant steps to restrict exports of US

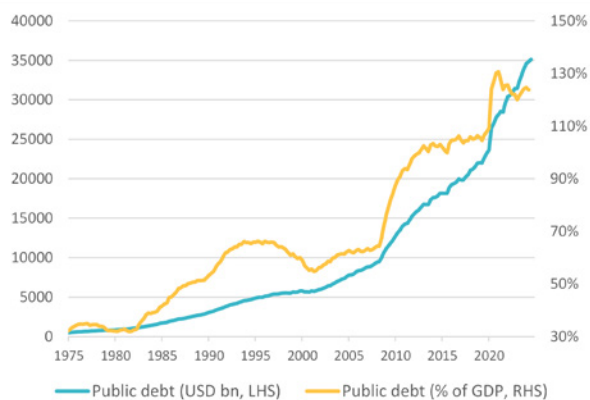
technology to China. It has also recently raised tariffs on imports from China in an array of strategic sectors such as semiconductors, EV, steel, or medical products. If elected, Kamala Harris would maintain the existing tariffs and trade restrictions, as well as possibly introducing additional levies on China.

Donald Trump, while aiming at less state intervention within the US economy, looks for assertive and increased interventionism when it comes to trade exchanges with the rest of the world. He intends to introduce a broad-based 10% tariff (possibly 20%) on all foreign countries' imports, and specific 60% tariffs on all imports from China. The stated goal of this approach is to boost the US industrial sector and to "make America the manufacturing superpower of the world." Donald Trump also appears more defiant toward international and multilateral organisations such as the UN, NATO and the IMF.

### Fiscal deficits are here to stay

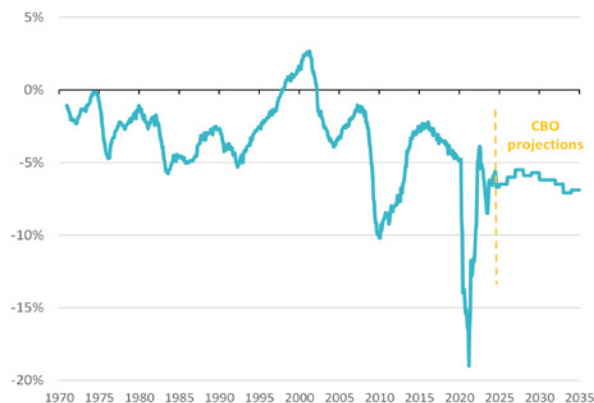
During Donald Trump's first term, the US public deficit steadily deteriorated until 2020. While the COVID-19 pandemic led to unprecedented deficits in 2020 and 2021, the Biden/Harris administration has not improved public finance since then. Instead, the federal deficit has continued to rise, approaching 7% of GDP this year and pushing U.S. public debt above \$35 trillion, or 120% of GDP.

#### US public debt has been rising at an ever-faster pace



In the continuity of this trend, the economic programs of the two candidates are not expected to lead to smaller public deficits or a slowdown in the growth of public debt. Schematically, Kamala Harris intends to finance the support targeted to middle-to-low-income households with the rise in the corporate tax and the income tax on top earners. Donald Trump intends to compensate the loss of fiscal revenues from corporate and individual taxes by tariffs on imports from the rest of the world. Most independent estimates show that both programs will hardly be neutral for public finances and that deficits will remain high in the years ahead. According to the latest report of the Congressional Budget Office, the US public deficit is expected to hover around 6% of GDP for the next ten years. Financial largesse by either candidate is likely to worsen the situation.

#### 12m US government budget balance (% of GDP, rolling 12m)



While the long-term trend for public finances is a real source of concern, in most developed economies like the United States like in most developed economies, it does not mean that a budget crisis is around the corner just yet. Deficits are not a burning issue if nominal economic growth is sufficient. Tellingly, since 2021, the debt-to-deficit ratio has declined in the US despite continuingly large deficits, because nominal GDP growth has been strong (real growth + inflation). If the US economy continues to grow around the current 5-to-6% nominal rate next year, expected deficits should not result in a worrying increase of the debt-to-GDP ratio. The risk lies in an unexpected deterioration of the economic situation, or a recession, which would simultaneously cause a deterioration of the public deficit and an increase in the debt-to-GDP ratio.

The election's impact on fiscal prospects is therefore likely to be broadly similar whoever becomes the next president: deficits are here to stay. In fact, the key element to gauge whether a further deterioration lies ahead or if some form of stabilisation is to be expected will lie in the composition of the US Congress. If the House of Representatives and the Senate are dominated by a majority of the President's party (a Sweep), then the new President will have more latitude to implement some of the most radical measures of the agenda, possibly leading to rising public deficits in the short run. Conversely, if the Congress is divided and the president's party does not have the majority in the two chambers, the ability to push forward ambitious legislations will be constrained, keeping the public deficit trajectory from altering much from the base case scenario.

## What to expect for equity markets?

In the table below, we summarise what are the possible policy impacts of each camp by economic sector. Policy changes by the Republican camp are likely to be more pro-cyclical, with the risk of being inflationary over the medium-term.

In a nutshell:

- ▶ Republican sweep: positive equities with a pro-cyclical bias such as financials, energy, and industrials.
- ▶ Democrat sweep: equities to remain attractive with renewables and infrastructure the main beneficiaries.

	Republican sweep	Democrat sweep
<b>EQUITIES</b>	(+) Republican policies are generally pro-cyclical which is positive for equities. The negative would be too aggressive trade barriers.	(-) Tighter regulation, higher taxes and more spending directed by the government are incrementally negative. However, equities may still be favoured vs other asset classes as a better alternative
<b>Technology</b>	(=) Both parties are likely to continue to pressure big tech on antitrust and data privacy issues. On the other hand, both parties want to stay ahead in terms of digitalisation and AI.	
<b>Financials</b>	(+) Pro-deregulation will favour consolidation/ profitability and a steepening yield curve would benefit banks.	(-) Tighter regulatory environment to prevail.
<b>Health Care</b>	(=) Status quo to prevail as not in favour of more healthcare reforms.	(-) More reform likely with stricter regulation on drug pricing, insurance, etc.
<b>Consumer Discretionary</b>	(-) With more trade tariffs, consumer goods prices will increase offsetting the benefits of lower taxes.	(=) No meaningful increase in trade barriers but no tax benefits.
<b>Communication Services</b>	(=) Deregulation likely offset by higher long-term rates.	(=) Support for digitalisation to be counterbalanced by regulation (M&A, data privacy).
<b>Industrials</b>	(+) Increase in infrastructure and defense spending will benefit the sector.	(=) Infrastructure spending to increase but tighter regulation emission regulation a headwind.
<b>Consumer Staples</b>	(=) Generally, no meaningful impact for the consumer staples.	
<b>Energy</b>	(+) Supportive of fossil fuel with lower regulation for the sector.	(-) Likely a continuation of the Biden administration policy that favours renewable energy sources and stricter environmental regulations.
<b>Utilities</b>	(-) Higher long-term interest rates are a risk.	(+) Push for green energy project and government supports.
<b>Materials</b>	(+) Increase in infrastructure spending will act as a positive but heavy industry will face tighter regulation by the democrats.	
<b>Real Estate</b>	(=) Lower tax and regulation may be offset by higher long-term interest rates.	(=) Subsidies for low-income households may not solve the supply issues.

## What to expect for bond markets?

### Key takeaways: the federal Reserve will lead, but fiscal policies will set the tone

The Federal Reserve's monetary policy and the broader economic trajectory will remain the key drivers of bond market performance in the coming years. A Kamala Harris presidency would likely result in strong support for ESG investments, and more stable trade relations which could help contain inflation risks. Conversely, a Donald Trump presidency might drive higher inflation, a stronger dollar, and greater market volatility, particularly for emerging markets and sectors exposed to global trade. In either case, investors will need to closely monitor the Fed's policy and broader economic trends, as these factors will have the largest impact on bond markets in 2025 and beyond.

### Government bonds: Fed's role in the yield curve

The 2024 election will have implications for government bonds, but the Fed's rate cut cycle will be the dominant force. The key question remains whether the U.S. economy can avoid recession and achieve a soft landing. However, the election's outcome will shape fiscal policies that could add pressure on long-term rates.

Kamala Harris as president would likely continue the current administration's approach, with increased spending on infrastructure, renewable energy, and social programs. This could result in higher government debt issuance and upward pressure on long-term yields. Should inflation remain moderate, the Fed's expected rate cuts could flatten the short end of the yield curve, but higher debt levels could keep long-term yields elevated. Harris's focus on moderate trade policies could help contain inflationary risks, stabilising bond markets to an extent.

On the other hand, Donald Trump in office would likely set a more aggressive fiscal expansion through significant tax cuts and higher defense spending, accompanied by tariffs. These policies could heighten inflationary risks, limiting the Fed's capacity for aggressive rate cuts. Under this scenario, the yield curve could steepen further, with long-term yields rising more sharply due to higher inflation expectations. Fiscal expansion and potential trade disruptions from tariffs could exacerbate inflation, pushing yields higher as investors demand more compensation for risk.

Regardless of the election outcome, a steepening of the yield curve appears likely. The trajectory of U.S. debt and fiscal deficits will continue to weigh on long-maturity bonds, limiting the potential for significant declines in long-term interest rates. A hard landing for the economy could temporarily push long-term yields lower, but structural pressures from deficits will persist.

### The US yield curve is likely to steepen in any case!



Source: Bloomberg

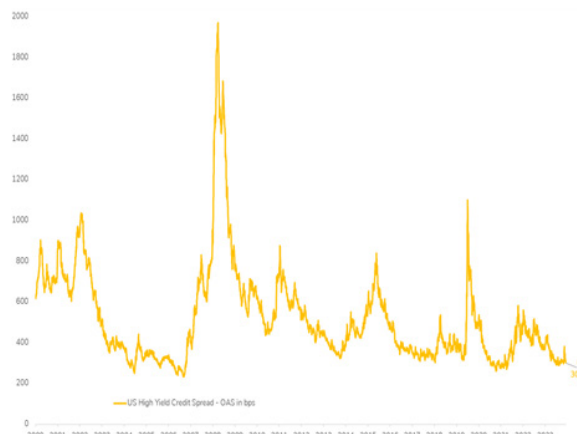
### Corporate bonds: fiscal policy and profitability vs. fiscal policy

The corporate bond market is especially sensitive to fiscal and regulatory shifts that will differ significantly depending on the election's outcome. However, the broader economic outlook and the Fed's rate cuts will remain crucial in shaping borrowing costs and credit spreads.

A Harris administration may introduce higher corporate taxes and stricter regulations, particularly in sectors like healthcare, technology, and finance. These measures could weigh on corporate profitability, potentially widening credit spreads as investors seek greater compensation for increased risk. However, Harris's dedicated support for sustainability and green energy initiatives could benefit the ESG bond market, with government incentives likely spurring increased issuance of green bonds and narrowing spreads in sectors aligned with environmental priorities.

In contrast, Trump's administration would likely focus on tax cuts and deregulation, which could enhance profitability in industries such as energy, manufacturing, and defense, tightening credit spreads in those sectors. However, Trump's trade policies, including broad tariffs, could drive up costs for multinational corporations, especially in technology and industrial sectors, potentially widening spreads due to increased costs. Furthermore, inflationary pressures could elevate borrowing costs, creating more volatility in the corporate bond market, particularly for high-yield issuers.

### The US high-yield spread - the most at risk?



Source: Bloomberg

### Emerging Market Bonds: dollar strength and trade relations

Emerging market bonds are overly sensitive to U.S. monetary policy and the strength of the U.S. dollar, making the Fed's rate cuts and the election's influence on trade policy pivotal.

A Trump-run office, with its focus on aggressive trade tariffs and fiscal expansion, could result in a stronger U.S. dollar, creating challenges for emerging markets. A stronger dollar would raise the cost of servicing dollar-denominated debt for these countries, leading to wider sovereign spreads and weaker currencies, particularly in nations dependent on U.S. trade, such as Mexico. Tariff-related disruptions could also exacerbate bond market volatility in these regions.

On the other hand, Harris is expected to pursue more moderate trade policies, likely leading to a weaker dollar, which would ease debt-servicing costs for emerging markets and mitigate capital outflows. Harris's emphasis on multilateral cooperation and stable trade relations could provide a more favourable environment for EM bonds, reducing the volatility that often hurts these markets during periods of global uncertainty.

## ESG bonds: a divergence in support

The ESG (Environmental, Social, and Governance) bond market has grown significantly in recent years, and the election outcome will influence its trajectory. Harris' presidency would likely accelerate ESG bond growth, with climate action and sustainability initiatives taking center stage. Increased green bond issuance would be expected, benefiting from favourable policies and incentives for clean energy and infrastructure. Trump would likely scale back domestic support for ESG initiatives, focusing on deregulation and traditional energy production. While global demand for ESG bonds might remain strong, domestic issuance could slow under Trump, especially as renewable energy subsidies are rolled back.

## For further information

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